



PUBLIC DISCLOSURE

September 29, 2014

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

First Federal of Northern Michigan
Charter Number 706210

100 S 2nd Ave
Alpena, MI 49707-2814

Office of the Comptroller of the Currency
Cleveland Field Office
200 Public Square Suite 1610
Cleveland, OH 44114-2301

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

INSTITUTION'S CRA RATING: This institution is rated Outstanding

The major factors supporting this rating are:

- The bank's loan-to-deposit ratio is more than reasonable given its size and financial condition, and the credit needs of its community.
- The bank originates a substantial majority of its loans within its assessment area.
- The bank's geographic distribution of residential mortgage loans and business loans throughout its assessment area is excellent.
- The bank's distribution of residential mortgage loans to borrowers of different income levels and business loans to businesses of different sizes is reasonable.
- The bank has been active in activities that have community development type characteristics, which reflects excellent responsiveness to community needs.

SCOPE OF EXAMINATION

This Community Reinvestment Act (CRA) Performance Evaluation covers the period from June 9, 2008, to September 26, 2014. In conducting our review, we used Small Bank CRA examination procedures. Since First Federal of Northern Michigan (First Federal) is not a Home Mortgage Disclosure Act (HMDA) reporter, we based our lending-related conclusions on a random sample of residential mortgage loans and business loans that the bank originated during 2012 and 2013. Residential mortgage loans and business loans are the bank's two largest loan portfolios, and we placed equal weight on the analysis of these two portfolios in order to arrive at our conclusions. We also used 2010 U.S. Census data, 2013 business geodemographic data, internal bank reports, and other information from governmental websites for our assessment. Furthermore, we contacted two members of the community to better assess the needs of the community, and the opportunities for financial institutions to lend and provide services to the area.

DESCRIPTION OF INSTITUTION

First Federal is a full-service community bank headquartered in Alpena, Michigan. It is a wholly owned subsidiary of First Federal of Northern Michigan Bancorp, Inc., a one-bank holding company. The bank has eight branches including its main office, with two branches in Alpena and one each in Cheboygan, Mio, Oscoda, Lewiston, Gaylord and Alanson. All of the branches also have onsite automated teller machines (ATMs).

As of March 31, 2014, First Federal had \$214.9 million in total assets and \$22.8 million in Tier 1 capital, and its loan portfolio totaled \$137.0 million (63.8 percent of total

assets). The bank offers a wide range of deposit and loan products. Loan products include residential mortgage loans, home equity loans, construction loans, various consumer-type loans including personal, automobile, and recreational vehicle loans, and a large variety of business loans. Table 1 provides a breakdown of the bank’s overall loan portfolio by loan type. To better assist in meeting the needs of low- and moderate-income borrowers, small businesses, and others that may not normally qualify for a loan, the bank also offers loans under the United States Department of Agriculture (USDA) Rural Housing Development program, the Michigan State Housing Development Authority (MSHDA), and the Small Business Administration (SBA). There are no legal or financial impediments limiting First Federal’s ability to meet the credit needs of its community. The bank received an Outstanding rating in its last CRA Performance Evaluation, which was dated June 9, 2008.

Table 1 – First Federal’s Loan Portfolio as of March 31, 2014			
Loan Category	Amount (\$000’s)	Percent of Total Loans	Percent of Total Assets
Residential Mortgage	73,289	53.48	34.10
Nonresidential Mortgage	48,062	35.07	22.36
Commercial Non-mortgage	10,996	8.02	5.12
Consumer	4,692	3.42	2.18
Total	\$137,039	100.00%	63.76%

Source: First Federal of Northern Michigan’s March 31, 2014 Call Report

DESCRIPTION OF ASSESSMENT AREA

First Federal’s assessment area (AA) is comprised of all of Alcona, Alpena, Charlevoix, Cheboygan, Crawford, Emmet, Iosco, Montmorency, Ogemaw, Oscoda, Otsego and Presque Isle Counties. All of these counties are located in the northern section of Michigan’s Lower Peninsula. Most of the AA consists of small towns and rural communities. The AA is bordered by both Lake Huron and Lake Michigan, and the area is a popular retirement and vacation destination. Tourism and related industries have a major economic impact on the economy in the AA.

First Federal’s management included whole counties in the bank’s AA due to the fact that many of the bank’s customers live in remote rural areas. While the bank’s eight branches are distributed over seven counties, management also includes counties in the AA that are between two counties containing branches, and counties that have a branch close to their border. The AA meets regulatory requirements, and does not arbitrarily exclude low- or moderate-income geographies. The AA is comprised of 86 census tracts within the twelve counties. Based on 2010 U.S. Census data, none of the 86 census tracts are low-income tracts, seventeen are moderate-income tract, 62 are middle-income tracts, and seven are upper-income tract. With the exception of six middle-income census tracts located in Alpena County, the middle-income census tracts within the AA are designated as distressed or underserved geographies.

A number of financial institutions serve the AA, providing for a competitive banking environment. There are 18 banks with offices in the AA, including six midsize or large banks and twelve community banks. There are also several credit unions that provide financial services within the AA. First Federal has the eighth largest deposit market share in the AA, with 5.39 percent of the total deposits according to the June 30, 2013, FDIC Deposit Market Share Report.

Economic conditions in the AA are poor, and unemployment rates are high. As of December 31, 2013, unemployment rates within the AA ranged from 9.6 percent to 16.0 percent. In comparison, the national and State of Michigan unemployment rates were 7.4 percent and 7.7 percent, respectively, as of the same date. Furthermore, 13.9 percent of the households in the AA are living below the poverty level.

Based on 2010 U.S. Census data, the AA contains less than three percent of the state's population, with 242,940 residents in 70,195 families and 104,633 households. The number and percentage of families in each income level within the AA are as follows: 14,441 (20.57 percent) low-income families; 14,233 (20.28 percent) moderate-income families; 16,297 (23.22 percent) middle-income families; and 25,224 (35.93 percent) upper-income families. In total, 28,674 families (40.85 percent) in the AA are designated low- or moderate-income. The 2013 Federal Financial Institutions Examination Council (FFIEC) updated median family income for Michigan non-metropolitan areas is \$51,700.

The AA has 21,808 non-farm businesses, according to 2013 Business Geodemographic Data, and 1,103 farm businesses. The total number of non-farm businesses with gross revenues of \$1 million or less is 16,693, and the total number of farm businesses with gross revenues of \$1 million or less is 1,089.

During our assessment of the bank's performance, we considered information provided by members of the community in order to obtain an understanding of the AA's needs and credit opportunities. We met with two community contacts, both of whom were members of nonprofit organizations that serve individuals and families. Both indicated the economy in Northern Michigan is poor, and that the area is in need of more employment opportunities. Other primary needs include more programs to assist low- and moderate-income borrowers with home purchases and home improvements, and for financial institutions to work with small businesses to better meet their credit needs.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Loan-to-Deposit Ratio

First Federal's loan-to-deposit (LTD) ratio is more than reasonable given the bank's size and financial condition and the credit needs of its community, and exceeds the standard for satisfactory performance. During the evaluation period of June 30, 2008, through

June 30, 2014, the bank’s average quarterly loan-to-deposit ratio was 98 percent. We evaluated First Federal’s average LTD ratio by comparing it to local competitors, which consisted of state and federally chartered institutions with total assets ranging from \$186 million to \$849 million. During the same period, the peer group’s average LTD ratio was 83 percent. This information shows that the bank’s average LTD ratio significantly exceeds local competition’s during the same period. Furthermore, First Federal’s performance is likely understated given the fact that the bank is an active residential mortgage lender that sells loans to the secondary market. First Federal sold \$27.5 million in loans in 2011, \$35.5 million in 2012, and \$14.0 million in 2013.

Lending in Assessment Area

First Federal originates a substantial majority of its residential mortgage loans and business loans within its AA, exceeding the standard for satisfactory performance. Table 2 shows that out of a sample of 138 residential mortgage and business loans originated during 2012 and 2013, 135 were made within the bank’s AA. The 135 loans represent 97.8 percent of the number of loans, and 91.9 percent of the dollar amount of loans, in the sample.

Type of Loan	Number of Loans					Dollars of Loans (000s)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Residential Mortgage Loans	60	100.0	0	0	60	7,493	100	0	0	7,493
Commercial/Business Loans	75	96.2	3	3.8	78	20,637	89.3	2,467	11.7	23,104
Total	135	97.8	3	2.2	138	28,130	91.9	2,467	8.1	30,597

Source: Sample of 60 residential real estate loans and 78 business loans.

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes

First Federal’s distribution of residential mortgage to borrowers of different incomes, including low- and moderate-income borrowers, is reasonable and meets the standard for satisfactory performance. The bank’s distribution of business loans to businesses of different sizes, including businesses with gross annual revenues of \$1 million or less, is also reasonable and meets the standard for satisfactory performance.

Residential Mortgage Loans

Table 3 shows the distribution of a sample of 60 residential mortgage loans originated by First Federal during 2012 and 2013 in its AA. The bank’s percentage of loans to low-

and moderate-income borrowers is significantly lower than the percentage of low- and moderate-income families residing in the AA. Based on the sample, First Federal made 3.3 percent of its residential mortgage loans to low-income borrowers, while 20.6 percent of the families in the AA are low-income. The bank made also made 10.0 percent of its residential mortgage loans to moderate-income borrowers, while 20.3 percent of families in the AA that are moderate-income.

Borrower Income Category	Low		Moderate		Middle		Upper	
	% of AA Families	% of # of Loans	% of AA Families	% of # of Loans	% of AA Families	% of # of Loans	% of AA Families	% of # of Loans
	20.6	3.3	20.3	10.0	23.2	21.7	35.9	65.0

Source: Sample of 60 residential mortgage loans; 2010 U.S. Census data; FFIEC Updated Median Family Income.

However, in assessing First Federal's performance we considered other factors. Table 4 compares the percentage of loans that the bank made to borrowers of different incomes to the percentage of loans that all lenders (aggregate) made to borrowers of different incomes in the AA, as well as the percentage of families in the AA in each income category. First Federal's lending to borrowers of different incomes is more closely aligned to aggregate lender performance than to the percentage of low- and moderate-income families in the AA, and aggregate lender performance reflects low loan demand from low- and moderate-income families. There is also an elevated level of competition in the AA, from a number of large national banks and credit unions. Low demand and significant competition negatively impacted the bank's ability to make loans to low- and moderate-income individuals.

Borrower Income Category	First Federal # of Loans (2012 and 2013)	First Federal % of Loans (2012 and 2013)	Aggregate Lenders % of Loans (2013)	Distribution of Families
Low-Income	2	3.33	8.30	20.57%
Moderate-Income	6	10.00	16.22	20.28%
Middle-Income	13	21.67	20.97	23.22%
Upper-Income	39	65.00	54.50	35.93%
Totals	60	100.00%	100.00%	100.00%

Source: 2013 Peer Group Mortgage Data; 2010 U.S. Census data; FFIEC Updated Median Family Income.

We also considered several other factors that affected our findings, including the fact that 10.4 percent of households within the AA live below the poverty line and the barriers that this may have on home ownership. It is especially difficult for the segment of the low-income population living below the poverty line to afford and maintain a home. The economic recession that occurred during the review period also reduced the demand for residential mortgage loans. Finally, First Federal works with a mortgage broker to work with borrowers seeking Rural Housing Development, Federal Housing Authority (FHA) and Veteran’s Administration (VA) loans, and many of these borrowers tend to be low- and moderate-income. This provides further support of the bank’s efforts to assist borrowers that may not otherwise qualify for a mortgage loan.

Based on this information, we conclude that First Federal’s performance lending to borrowers of different incomes, including to low- and moderate-income borrowers, is reasonable.

Business Loans

Table 5 shows the distribution of a sample of 75 business loans originated by First Federal during 2012 and 2013 within the bank’s AA. The bank’s percentage of loans to businesses with gross annual revenues of \$1 million or less is very close to the percentage of businesses in the AA with gross annual revenues of \$1 million or less, reflecting a reasonable distribution of loans to businesses of different sizes. Based on the sample, First Federal made 73.3 percent of its loans to business with gross annual revenues of \$1 million or less, while 76.6 percent of the businesses in the AA are in that revenue category. Revenue information is unavailable or unknown for 19.7 percent of the businesses in the AA.

Table 5 – Distribution of First Federal’s Business Loans				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses	76.6	3.7	19.7	100%
% of Bank Loans in AA by #	73.3	25.3	1.3	100%
% of Bank Loans in AA by \$	47.9	51.3	0.8	100%

Source: Sample of 75 business loans; 2013 Business Geodemographic Data

Geographic Distribution of Loans

First Federal’s geographic distribution of residential mortgage loans and business loans throughout its assessment area is excellent, and exceeds the standard for satisfactory performance.

Residential Mortgage Loans

Table 6 shows the geographic distribution of a sample of 60 residential mortgage loans originated by First Federal during 2012 and 2013 in its AA. The distribution of loans is excellent, given existing lending opportunities and the bank’s performance context. Based on the sample, First Federal originated 21.7 percent of its residential mortgage loans in moderate-income census tracts within its AA. This compares favorably to the 15.8 percent of the AA’s owner-occupied housing that is located in these census tracts.

Table 6 - Geographic Distribution of First Federal’s Residential Mortgage Loans								
Census Tract Income Level	Low		Moderate		Middle		Upper	
	% of AA Owner Occupied Housing	% of # of Loans	% of AA Owner Occupied Housing	% of # of Loans	% of AA Owner Occupied Housing	% of # of Loans	% of AA Owner Occupied Housing	% of # of Loans
	0	0	15.8	21.7	73.4	75	10.8	3.3

Source: Sample of 60 residential real estate loans; 2010 U.S. Census data.

Business Loans

Table 7 shows the geographic distribution of a sample of 75 business loans originated by First Federal during 2012 and 2013 in its AA. The distribution of loans is excellent, given existing lending opportunities and the bank’s performance context. Based on the sample, First Federal originates 29.3 percent of its business loans in moderate-income census tracts within its AA. This compares favorably to the 14.5 percent of the AA’s businesses that are located in these census tracts.

Table 7 - Geographic Distribution of First Federal’s Business Loans								
Census Tract Income Level	Low		Moderate		Middle		Upper	
	% of AA Businesses	% of # of Loans	% of AA Businesses	% of # of Loans	% of AA Businesses	% of # of Loans	% of AA Businesses	% of # of Loans
	0	0	14.5	29.3	74.0	69.3	11.5	1.3

Source: Sample of 75 business loans; 2013 Business Geodemographic Data.

Qualified Investments and Community Development Services

First Federal originated 13 community development loans during the review period, totaling \$2.46 million. All funds were specifically targeted to benefit low- and moderate-income persons, moderate-income census tracts within the assessment area, underserved middle-income census tracts within the assessment area, or organizations whose main purpose is providing economic development, revitalizing central business districts, and offering assistance to attract, expand, and retain small businesses throughout the assessment area.

During the review period, the bank also purchased a \$400 thousand bond to finance improvements to streets, parks, and utilities in the Village of Hillman. The revitalization project includes improvements to census tracts designated as moderate-income, nonmetropolitan geographies, and distressed and underserved nonmetropolitan middle-income geographies. Furthermore, during 2013, First Federal made 25 cash donations to community development organizations totaling \$4,000. Organizations benefitting from these donations included those involved in affordable housing, economic development, revitalization and stabilization of business districts, and community services to low- and moderate-income individuals and households.

First Federal has eight branches and eight ATMs in the assessment area. The bank's main office and its Cheboygan office are located in moderate-income census tracts, while the Alpena-Ripley, Mio, Oscoda, Lewiston, Gaylord and Alanson offices are located in middle-income census tracts. Of the branches located in middle-income geographies, two are located in underserved census tracts, and two are located in distressed and underserved census tracts.

In addition to its full-service branches and ATM locations, First Federal offers on-line and mobile banking services that provide customer access to accounts and an automated bill payment system, as well as a telephone system that allows customers to transfer funds between their own deposit accounts. Free checking account products are available to all customers. Since there is no data to reflect how this has impacted low- and moderate-income segments of the community, we cannot place any weight on these products for CRA purposes.

Through its employees, First Federal is involved in a variety of community development services. Many of the bank's employees and officers, using their financial expertise, are involved in non-profit organizations providing services for low- and moderate-income individuals or economic development for small businesses. Performance in this area reflects excellent responsiveness to community development service needs.

Responses to Complaints

There have been no consumer complaints related to the bank's CRA performance during this evaluation period.

Fair Lending or Other Illegal Credit Practices Review

Pursuant to 12 C.F.R. 25.28(c), or 12 C.F.R. 195.28(c), in determining a national bank's or federal savings association's CRA rating, respectively, the OCC considers evidence of discriminatory or other illegal credit practices in any geography by the bank or FSA, or in any assessment area by an affiliate whose loans have been considered as part of the bank's or FSA's lending performance.

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.